Supreme Court, U. S.
FILED
JUL 26 1950
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1949

No. 221

LOUIS W. GORDON, COMMON STOCKHOLDER OF LONG ISLAND LIGHTING COMPANY,

Petitioner,

against

SECURITIES AND EXCHANGE COMMISSION, LONG ISLAND LIGHTING COMPANY, QUEENS BOROUGH GAS AND ELECTRIC COMPANY, NASSAU & SUFFOLK LIGHTING COMPANY,

Appellees-Respondents.

PETITION OF LOUIS W. GORDON FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Dated July 24, 1950.

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PETITION OF LOUIS W. GORDON FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

LOUIS W. GORDON, the holder of 50,000 shares of the common stock of Long Island Lighting Company, prays that a writ of certiorari issue to review a final order of the United States Court of Appeals for the Second Circuit which affirmed in all respects an order of the United States District Court for the Eastern District of New York. The said order of the District Court (R. 399) approved as "fair and equitable" and ordered the enforcement of a plan which had been approved by order of the Securities and Exchange Commission pursuant to Section 11(e) of the Public Utility Holding Company Act (R. 340).

District Court opinion reported

Opinions and Proceedings Below

The opinions below have not yet been officially reported. They are reprinted in the Record, viz.: Original Findings and Opinion of the Commission dated November 2, 1949 (R. 145-297). Opinion of the District Court dated February 10, 1950 (R. 363). The first opinion of the Court of Appeals dated June 1, 1950 (R. 860-869) remanded the cause to the Commission on one issue and affirmed the District Court in other respects. On petition by the Commission for reconsideration, accompanied by a Supplemental Findings and Opinion of the Commission dated June 5, 1950 (R. 881-891), the Court of Appeals rendered a second opinion dated July 5, 1950 (R. 936-938) which affirmed the District Court in all respects. The Commission's Original and Supplemental Findings and Opinion are set forth in Holding Company Act Release Numbers 9473 and 9900.

Jurisdiction of this Court

The jurisdiction of this Court to grant this petition is founded on Section 1254(1) of the Judicial Code made applicable by Section 25 of the Public Utility Holding Company Act of 1935.

Statutes Involved

The relevant provisions of the statutes involved are quoted in Appendix A of this petition. The statutes involved are: Sections 11(e) and 20(c) of the Public Utility Holding Company Act of 1935; the Federal Administrative Procedure Act (5 U.S.C., Sections 1001 and 1004), and the Act of April 9, 1948 (11 U.S.C., Section 208).

Questions Presented

1. Is the requirement that the Commission's orders and findings in connection with reorganization plans must

be supported by "substantial evidence" and arrived at "in accordance with legal standards" (*S.E.C.* v. *Central Illinois Securities Corporation*, 338 U. S. 96), satisfied by an administrative determination which holds in effect that—

> (a) Since it is difficult to determine to what extent the initial shareholders of a proposed consolidated public utility operating company will benefit, in terms of increase in net income, from a certain and measurable growth and expansion of the company's business, plant and facilities, because the financing program, viz., the extent, terms or manner in which outside capital necessary to finance a part of the cost of expansion will be raised, has not yet been determined by the management;
>
> (b) The difficulty will be resolved by estimating the future income of the proposed consolidated company, for purposes of passing upon the fairness of the plan of consolidation, as limited to the earning power of plant and facilities which were in existence as of the close of the last quarterly accounting period ended during the administrative hearings, and by assuming that the initial stockholders of the consolidated company will derive no benefit whatever from expansion and additions to plant and facilities subsequent to that date;
>
> (c) All this without any evidence being received or considered with respect to the extent, terms and manner of necessary outside financing, although such evidence is conventional, procurable and has been proffered.

Stated differently, may the Commission make a finding in the negative as to an essential and indispensable ele-

ment in valuing prospective earnings by refusing to consider any evidence with respect to it on the ground of the alleged complexity of the question, especially when the Commission's own prior practice has been to consider evidence of identical character and when, on the record now before this Court, it is established that such a negative finding of the Commission has already been proven wholly wrong as a matter of fact?

2. Do the provisions of the Act of April 9, 1948 (11 U.S.C., Sec. 208) directing all Courts, including this Court, reviewing railroad reorganization plans approved by the Interstate Commerce Commission, to give independent consideration to post-approval developments express a Congressional policy beyond the literal scope of that statute (*Gooch* v. *Oregon Short Line Railroad Company*, 258 U. S. 22, 24; cf. *S.E.C.* v. *Central Illinois Securities Corporation*, 338 U. S. 96, at page 126), equally applicable to S.E.C. approved reorganization plans under the Public Utility Holding Company Act? And do the post-approval developments in this case require the remand of the Plan to the Commission for reconsideration?

3. Are the requirements of basic procedural due process, as implemented by the Federal Administrative Procedure Act and the Public Utility Holding Company Act, satisfied by the following action of the Commission: Following a decision of the Court of Appeals directing the District Court to remand a Section 11 plan to the Commission on a substantial issue, but without awaiting such remand, the Commission issues an *ex parte* Supplemental Findings and Opinion which pretends to express heretofore unexpressed grounds for its original decision but from which it is clear that the Commission has in fact made new findings of fact, based on assumptions of fact not in the record, as well as new conclusions of law, all

formulated and arrived at upon the representations of the proponents of the plan and the recommendations of the Commission's Public Utility Staff, without any notice or opportunity to be heard having been afforded to the opponents of the plan?

Is such lack of notice and opportunity to be heard cured by the following procedure adopted by the Court of Appeals: The opponents of the plan are given leave to file an "Answer" with the Court to the Commission's Supplemental Findings and Opinion. The Answer filed makes an offer of proof, based on documentary evidence, of facts which the opponents of the plan would have offered to prove before the Commission had they been given an opportunity to do so and which, if made, would have established that the Commission's assumptions and findings of fact made in its Supplemental Findings and Opinion are wholly without foundation. The Court of Appeals, without considering and, in effect, ignoring such offer of proof, approves the Commission's Supplemental Findings and Opinion as a "rational guess", and as "not necessarily wrong".

4. Is the Commission giving the common stockholders of one of the constituent companies entering into a consolidation the "substantial equivalent" of their rights when it first determines the participation of such constituent company in the consolidation and accordingly allocates the new stock of the consolidated company issuable to *all* the security holders of such constituent company at 83.2% of the total stock to be issued by the consolidated company under the plan, but then apportions the participation in such 83.2% of the total as between the preferred and common stockholders of this constituent company *as if* the constituent company had received only 80.43% of the total?

Statement of Essential Facts and Arguments Bearing on Questions Presented.

(A)

Arbitrary Assumption by the Commission That the Growth of the Long Island System Will be of no Value or Benefit to the Initial Stockholders of the Consolidated Company.

The plan involved in this proceeding is an amended "voluntary" plan of consolidation and recapitalization (hereinafter called the "Plan") of three electric and gas utility companies, Long Island Lighting Company (hereinafter called "Long Island"), Queens Borough Gas and Electric Company (hereinafter called "Queens") and Nassau & Suffolk Lighting Company (hereinafter called "Nassau"), filed by the companies pursuant to Section 11(e) of the Public Utility Holding Company Act. Long Island owns all the common stock of Queens, and Queens owns all the common stock of Nassau. The three companies, by virtue of their electric and gas franchises, have a monopoly in the supply of gas and electricity for light, heat and power in the counties of Nassau and Suffolk on Long Island (with the exceptions noted below)* and in the section of Queens County on Long Island known as the Rockaway District.

Under the Plan, (a) the funded and other debt of the constituent companies is to be assumed by the consolidated company, (b) the outstanding preferred stocks of the con-

* Patchogue in Suffolk County is served with electricity by a local electric company and the communities of Greenport (Suffolk County) and Freeport and Rockville Center (Nassau County) receive their electricity from municipal systems. The area covered by the electric and gas franchises of the Long Island System is shown on maps designated as Applicants' Exhibits 16, 16A, 17 and 17A, S.E.C. record.

stituent companies, each of which has substantial accumulations of back dividends, and the outstanding common stock of Long Island, the "top" company, are to be exchanged for the shares of stock of the Consolidated Company, to consist entirely of common stock, and to be divided as follows:

	Proportion of New Common
To preferred stocks of Long Island	76.98%
To preferred stock of Queens	11.51%
To preferred stock of Nassau	5.80%
To all preferred stocks	94.29%
To Long Island common	5.71%
Total	100%

(R. 341)

The allocation of the new common stock to be issued by the Consolidated Company under the Plan was predicated by the Commission, as it had to be under the decision of this Court*, upon an estimate by the Commission of the "foreseeable" future net income of the constituent companies and of the Consolidated Company. In its Opinion and Findings, the Commission estimated such foreseeable future net income, on a *per annum* basis, as follows:

Long Island	$2,815,000
Queens	450,000
Nassau	235,000
Total	$3,500,000 (R. 209)

Despite the uncontradicted evidence of phenomenal and continuing growth of the territory served by the Long

* *Consolidated Rock Co.* v. *Du Bois*, 312 U. S. 510, 512; *Group of Investors* v. *Milwaukee R.R. Co.*, 318 U. S. 523, 540-1; *S.E.C.* v. *Central Illinois Securities Corporation*, 338 U. S. 96, 146.

Island System and of the consequent continuing expansion of the business, plant and facilities of the System* the Commission nevertheless (a) estimated such future net income at an amount precisely equal to the allowable return on plant and facilities in existence on March 31, 1949 less so-called "income deductions", viz., essentially interest on the outstanding debt (R. 207-209), and (b) assumed, without any evidence in the record to support such assumption, that the post-March 31, 1949 additions to plant and properties will produce no incremental earnings for, and hence will not benefit, the initial stock investment of the Consolidated Company. Some evidence was adduced at the hearings before the Commission with respect to the amount of new construction required during the next five years, then estimated at 65,000,000 (R. 751) and since greatly surpassed (R. 928; see Appendix B), but no evidence was submitted or considered by the Commission as to the manner in which the new construction was to be financed, the probable cost and extent of necessary outside financing, and the estimated amount of residual earnings which the existing stock investment may be expected to derive from additions to plant and facilities after providing for the cost of the necessary outside financing. All estimates of net income were explicitly stated to have been made on the basis of the earning power of existing plant and facilities and without attempting to forecast the effect on future net income applicable to the existing stock investment of additions and expansion to plant and facilities (R. 725-743) despite the fact that a large scale expansion program was both planned and in progress.

In its brief filed with the Court of Appeals, the Commission stated its position as follows:

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* See the Summary of the relevant facts in Appendix B attached to this petition.

> "It is admittedly difficult enough to estimate future earnings on the basis of present facilities and past earnings of the company. How much more uncertain and parlous would be an estimate of future earnings based on facilities which had not yet come into being at all and which would have to be financed at unknown future dates, under unknown market conditions, by combinations of securities not as yet determined by the management or considered by the appropriate regulatory authorities" (p. 4).

The Commission refused to consider specific evidence proffered to it by petitioner following the issuance of its original Findings and Opinion (R. 766-820), including expert evidence with respect to attainable financing programs (R. 814-820) tending to show that the necessary additions to plant and facilities will in fact produce a substantial net income to the initial stockholders of the Consolidated Company over and above the income to be derived from the plant and facilities existing on March 31, 1949.

The finding of the Commission that additions to plant and facilities subsequent to March 31, 1949 will not produce any additional net income to the existing stock investment and that such growth must be appraised at no value for the purposes of the Plan—without any evidence in the record in support of such a finding—violates the requirement laid down by the decisions of this Court that *all* essential findings made by the Commission in passing upon the fairness of reorganization plans must be supported by substantial evidence (*Ecker* v. *Western Pacific Railroad*, 318 U. S. 448 at pp. 473 and 477). It is in conflict with the Commission's own practice in other cases in which the Commission itself insisted on the introduction of evidence of a character it refused to consider here and found and concluded that future additions to plant and

facilities will result in a predictable increase in the future net income applicable to the existing stock investment after providing for the cost of necessary outside capital.*

* The *Northern States Power Company* case, S.E.C. Holding Company Act Release No. 7950, December 24, 1947, is the clearest and most specific illustration. In connection with estimating for purposes of the Sec. 11 Plan the foreseeable future earnings of the Northern States Power Company of Minnesota, the company itself *at the request of the staff of the S.E.C. Public Utility Division* (p. 18) prepared forecasts of net income applicable to the then existing stock investment for the years 1947 to 1951, both inclusive, arriving at net income figures of $7,190,000 for 1947 and higher figures for each year thereafter, culminating in a net income figure of $8,820,000 for 1951 (p. 19). In making that estimate, the Company assumed future additions to plant of $96,000,000 and made specific projections covering the extent and manner of financing the estimated additions during that period and the cost of such financing. The company "projected the cost of new capital on the basis of anticipated costs of raising funds" (p. 20). Similar forecasts were submitted by Stone and Webster, a firm of engineering experts, for the common stockholders as well as for other stockholders. Stone and Webster estimated a five-year construction program of $90,000,000 and yearly net earnings applicable to the pre-existing stock investment from $8,000,000 in 1947 to $10,225,000 in 1951, the average of which was computed at $8,700,000 per annum (p. 20). The difference in these net earnings forecasts was due to some extent to differing estimates of the "cost of financing (future) capital expenditures" (p. 21). But each estimate specifically projected the amount of estimated future construction during the next five years; what portion of it would be financed from the company's retained earnings and other cash resources; what portion from the sale of bonds, preferred stocks and (in the case of the company's estimate) new common stock, respectively; the anticipated cost of the required outside capital, viz., the terms upon which each class of the projected new securities will have to be sold. After considering these projections, the S.E.C. held that a future financing program lying somewhere between the two projections can reasonably be assumed; that a part of the future construction can be financed from cash resources, depreciation moneys and 15% to 20% of future net earnings; that the balance can be financed from bonds at 3¼% to 3½% yield basis and from preferred stock having a dividend yield of 4½%; and although some new common stock will also have to be sold, it will be less than that projected by the company's experts (p. 27). The opinion states flatly:

> "The long range level of earnings must be judged in terms of the rate base which will result from the potential additions to the plant which we have discussed". (p. 29).

It finally estimated the average long range level of net earnings at

The approval by the District Court and the Court of Appeals of the Commission's negative finding on this point, made without any evidence, constitutes a serious misconception of the scope of the judicial review of the orders of the Commission under Sec. 11(e) of the Holding Company Act. It is irreconcilable in principle with another decision of the same Court of Appeals, *S.E.C.* v. *Leventritt* (1950), 179 Fed. (2) 614, petition for certiorari filed by the Government July 20, 1950.* In the case at bar, it has resulted in a confiscatory expropriation of values inherent in the Long Island common stock for the benefit of the preferred stockholders.

The error in the said finding of the Commission has been conclusively demonstrated by events subsequent to the approval of the Plan. As against the Commission's estimate of future net income of $3,500,000 based on the

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$8,200,000 per year applicable to the then existing stock investment or somewhere between the average future net income projected by the company and by the common stockholders, respectively. This estimate included a substantial increment in earnings accruing to the then existing stock investment from future plant additions, over and above the estimated earnings attributable to the already existing plant and facilities.

* In the *Leventritt* case, the Court of Appeals held that there was no evidence in the S.E.C. record tending to support the finding of the S.E.C. that stock purchase warrants were without value for purposes of a plan and hence this negative finding cannot be judicially approved but must be remanded for further proceedings. The Court stated:

> "* * * Any appraisal whatever must be largely composed of nebulous factors, and, to speak frankly, can at best be no more than as honest a guess, as possible * * * in finding that the 'warrants' at bar had no value whatever is just as much of a guess as the finding that they had some particular value. We are forced to deal in prophecies in any event; and, unless courts are to have no review at all, they cannot avoid acting on such impalpable ingredients. *Clearly there can be no appraisals which no substantial 'evidence' supports;* and one guess is not as good as another, unless all findings of the Commission are to be final * * *. *We cannot agree that there was any evidence 'substantial' or insubstantial to support the finding that these 'warrants' were wholly worthless* * * *".

earning power of the March 31, 1949 plants and properties, the companies' 1950 budget estimate shows a net income applicable to the existing stock investment of $4,027,000 or more than $500,000 in excess of the Commission's estimate (R. 908; 935). This is in line with interim 1950 earnings (R. 907; 920-927).* This increase is not the result of temporary or extraordinary conditions but of the continuing expansion of plant and properties at an unprecedented rate (R. 928) to keep with the population, residential and industrial growth of the area served by the Long Island System which is one of the fastest growing areas in the United States (R. 779-781) and to a permanent increase in the rate base which has already taken place (R. 910).

(B)

Disregard of Post-Approval Developments.

Petitioner has repeatedly sought to bring to the attention of the Commission (R. 772), the District Court (R. 362), and the Court of Appeals (R. 847), changes in circumstances and developments subsequent to the original approval of the Plan by the Commission. These developments (see summary annexed as Appendix B to this petition) prove the original earnings estimate made by the Commission hopelessly wrong. The Courts below have refused to require the Commission to reconsider the fairness of the Plan in the light of these developments. The failure to do so and to dismiss these developments as trivial was a serious abuse of discretion.

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* The simplest computation will show that an increase of $500,000, or even of $250,000, in annual net income would substantially shorten the theoretical "payout" of preferred arrearages, substantially increase the income expectancy of the common (which is entitled to all income after covering the limited priority claims of the preferred), and would render the 5.71% of the stock allocated to the common necessarily unfair and confiscatory (cf. R. 233-234).

This Court has the power and indeed the duty to appraise independently the significance of the post-confirmation changes and to determine for itself whether or not they require remand to the Commission, both under general principles* and by reason of a statutory enactment, the Act of April 9, 1948 (11 USCA Sec. 208) (quoted, including its legislative history, in Appendix A hereto), which specifically directs all reviewing Courts to do so. That Act specifically deals only with railroad reorganization plans approved by the Interstate Commerce Commission under Section 77 of the Bankruptcy Act. However, in view of the holding of this Court that the functions of the Federal Courts, in passing upon Plans under Section 11 of the Holding Company Act on the one hand, and railroad reorganization plans on the other, are the same (*S.E.C.* v. *Central Illinois Securities Corporation,* 338 U. S. 96), the policy and intent of Congress there expressed must be held applicable to Section 11 Plans as well. (Compare *Gooch* v. *Oregon Short Line Railroad,* 258 U. S. 22, 24).

(C)

The Issue of Procedural Due Process.

The Commission's original Opinion and Findings, in estimating the foreseeable future earnings, deliberately excluded the annual sum of $250,000 (after provision for federal income taxes) which, according to the uncontradicted evidence, would be saved upon consolidation through eliminating duplicate functions, records and personnel (R. 210). The Commission mistakenly assumed that for purposes of allocating the new securities under the Plan as between the preferred stockholders on

* *S.E.C.* v. *Central Illinois R.R.*, 338 U. S. 96, footnote 44. In *Ecker* v. *Western Pacific R.R.*, 318 U. S. 448, 507-8, information covering post-approval developments was added to the record before this Court by stipulation of the parties.

the one hand, and the common stockholders on the other, it is *required* to disregard additional earnings made possible through consolidation savings, "which can be obtained only after consolidation of the three companies" (R. 203). Thereby, an obvious windfall was conferred upon the preferred stockholders to the detriment of the Long Island common stock. The Court of Appeals' original decision held that consolidation savings *must* be taken into account in the allocation process and remanded the case to the Commission on that issue (R. 868-869).

The Commission, without awaiting the remand, filed a Supplemental Findings and Opinion with the Court of Appeals which it termed an "explanation". A fair reading of the Supplemental Findings and Opinion makes it abundantly clear that it was in no sense, as asserted, a statement or "articulation" of the original reasons of the Commission for excluding this item, but an *ex post facto* formulation of judgment based upon subsequent consideration of additional facts and assumptions of facts not in the record. The Supplemental Findings and Opinion was rendered by the Commission on the motion of the companies and the recommendations of the Commission's staff without any notice or opportunity whatever to the opponents of the Plan to be heard or to adduce either facts or arguments having a vital bearing on the issues dealt with by the Commission in its Supplemental Findings and Opinion (R. 902-903).

The Supplemental Opinion in substance held that (a) "*if*" the Court of Appeals is right and the Commission is required to consider the consolidation savings as a potential asset of the consolidated company to be taken into account in its allocation of securities under the Plan, (b) this would not change the result of the Commission's

original allocations *because* (c) its original earnings estimate had been predicated upon the full rate of return allowed by the New York Public Service Commission, therefore (d) in good years, consolidation savings would have to be passed on to the consumers by way of rate reductions and (e) in bad years, the savings would be needed because without them the consolidated company might not be able to earn the full allowable return (R. 888-890). The Commission's estimate of earnings, however, as found by the Court of Appeals (R. 864), had been predicated upon plants and properties in existence on March 31, 1949, viz., on the March 31, 1949 rate base. Obviously, no fair or honest finding of fact to the effect that post-consolidation savings will produce income in excess of the allowable return and hence will have to be returned to the consumer in rate reductions can be made in June of 1950, based on the March, 1949 rate base and without inquiry as to the increase in the rate base which has since taken place and may take place by the expected date of consolidation.

When the Commission filed the Supplemental Findings and Opinion with the Court of Appeals with a petition for a reconsideration by the Court of Appeals of its original decision, this petitioner made a documented offer of proof to the Court of Appeals in his answer to the petition based on the most recent financial information emanating from the companies, demonstrating that there has already occurred an increase in the rate base since March 31, 1949 to an extent which justifies the retention by the consolidated company of an annual sum greatly in excess of $250,000 of additional net earnings over and above the amount originally estimated by the Commission and that this very large addition to the rate base both makes it certain that these post-consolidation savings will *not* have to be passed on to the consumers by way of rate reductions in

good years and also provides its own cushion of safety for bad years (R. 906-913). The Court of Appeals ignored this offer of proof, did not think it necessary to direct the Commission to consider it, and accepted the Commission's "explanation" as a "rational guess"—"not necessarily wrong" (R. 938), though, if the facts as to which the petitioner made its documented offer of proof is accepted as true, the guess by the Commission was demonstrably based on assumed facts known to be false.

The Commission's Supplemental Findings and Opinion amounted to both an "order" and an "adjudication" as defined in the Administrative Procedure Act (5 U.S.C., Sec. 1001), and its *ex parte* rendition was contrary to the requirements of the Administrative Procedure Act (5 U.S.C., Sec. 1004), and the Holding Company Act itself (Sec. 20(c)) requiring notice and opportunity to be heard prior to any "order" or "adjudication" of the character involved here, and contrary to procedural due process.*

In acting on the motion of the companies *ex parte* and with precipitate speed (R. 902-3), the Commission also violated its own Rules of Practice, expressly requiring notice and opportunity to reply to be given to adverse parties in case of all motions and procedural applications. (See Rule VI of Commission Rules of Practice quoted in R. 903.)

The action taken by the Court of Appeals in connection with the Commission's Supplemental Findings and Opinion was a clear violation of the "substantial evidence" rule and a complete abdication of judicial review.

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* It should be noted that the Public Utilities Staff of the Commission which has constant and special access to the Commission, had taken a position in favor of the Plan and was naturally interested in justifying what had been done. The Commission itself has often emphasized that the Staff is one of the *parties* before the Commission. *American & Foreign Power Company, Inc.*, HCA Release No. 7815 at p. 67. Hence the Supplemental Findings and Opinion, in a very real sense, was an adjudication based on hearing the advocates of one side only.

(D)

Arbitrary Denial by Commission to the Common Stockholders of Their Share of Additional Consolidation Benefit.

The original Opinion and Findings of the Commission estimated the separate prospective net incomes of the constituent companies, prior to any consolidation savings, as follows:

Long Island	$2,815,000	80.43%
Queens	450,000	12.86%
Nassau	235,000	6.71%
	$3,500,000	100%

(R. 226)

However, because of the superior credit position and the high quality of the assets contributed by Long Island to the consolidation, as compared to Queens and Nassau, these original estimated net income contributions were "weighted" by applying a weight factor of 1 to Long Island and a weight factor of 0.8 to Nassau and Queens, resulting in the following reallocation of the estimated consolidated future net income and the following corresponding allocation of the stock of the Consolidated Company as between the constituent companies, before adjustment for inter-company claims:

Long Island	$2,929,500	83.7%
Queens	374,500	10.7%
Nassau	196,000	5.6%
	$3,500,000	100%

(R. 228-229)

Yet, in determining the relative participations of the Long Island common and the Long Island preferred in the portion of the Consolidated Company's stock allotted to Long Island, the Commission proceeded to make such

apportionment on the assumption that the future income to be apportioned between them is the sum of $2,815,000, viz., the separately estimated prospective net income of Long Island, which is only 80.43% of the total (R. 233-234). That is to say, the Commission erroneously assumed that the new securities must be allocated as between Long Island preferred and Long Island common not on the basis of the net income which will in fact accrue from the Consolidated Company to the securities allotted to Long Island, in view of the total allocation of new stock to Long Island, but on the basis of a hypothetical separate income of Long Island whose corporate existence will have disappeared. The effect of this error was to give an additional windfall to the Long Island preferred to the detriment and prejudice of the Long Island common. This error has been pointed out to (R. 914-6) but ignored by the Court below. In starting the "apportionment" process as between Long Island preferred and common, the Commission erred, as a matter of law, in starting out as it did with $2,815,000, and should have started out with 83.2% of the estimated $3,500,000, or $2,925,000 plus 83.2% of the $250,000 of consolidation savings, or $209,250, viz., with $3,134,250. It is obvious that on such a basis, the theoretical "pay out" of accumulated dividends of the Long Island preferred will be materially shortened, the income expectancy of the Long Island common materially increased and, hence, the common would be entitled to a necessarily higher allocation of consolidated company's new common stock than the 5.71% allotted to the old common under the Plan.

Reasons Relied on for Allowance of Writ

1. The position of the Commission, explicitly approved by the Courts below, that no matter how great the rate and extent of the expected growth of an enterprise is in terms

of expansion of plant and facilities—especially of a public utility operating company which has a monopoly of service in the area covered by its franchises—it must be conclusively presumed, for purposes of valuing the interest of its stockholders, that they will not retain any incremental earnings from such expansion, amounts to a virtual emasculation of the rule of going concern valuation based on long range prospective earnings, frequently laid down by this Court. It is contrary to fundamental principles of common sense. The holding, if allowed to stand, will have an undesirable effect not only on other Section 11(e) Plans under the Holding Company Act, but on the corporate reorganization law in general.

2. The *ex parte* practice sanctioned in this case in connection with the Supplemental Findings and Opinion of the Commission raises an important question of administrative due process. If allowed to stand, it will be an invitation to the Commission to use this device to re-fashion and to supplement its findings and conclusions after they shall have been found wanting in the requisite legal standards—without any prior opportunity to the adversely interested parties to address themselves to the Commission on the subject. It will fatally weaken all power of judicial review.

3. To what extent the more detailed scheme of Section 77 of the Bankruptcy Act, including the 1948 statute relating to post-confirmation developments, applies to proceedings under Section 11 of the Public Utility Holding Company Act, presents an important question of federal law.

4. The Opinion and Findings of the Commission evidence either confusion or prevarication on the issue of consolidation benefits in their bearing on the allocation of securities under a plan which calls for consolidation. This

is believed to be largely due to a misconstruction or distortion of the following statement made by this Court in *S.E.C.* v. *Illinois Central Securities Corporation,* relied on by the Commission (R. 887):

> "When the Commission values a security interest by determining the value that interest would have if it were not for the present liquidation or reorganization required by the Act, it substantially complies with the statutory mandate." (338 U. S. 96, 140)

This statement was made in relation to a holding in the *Otis* case that in view of the going concern theory of valuation in Section 11(e) proceedings, charter provisions giving a preferred stock a premium upon liquidation must be disregarded in connection with *liquidation* plans under Section 11. To hold that the common stock of a corporation entering into a consolidation should be valued as against senior stock of the same corporation as if consolidation were *not* taking place—when the corporation itself receives definite consolidation benefits both in terms of additional allocation of new securities under the Plan to reflect its *weighted* contribution to the consolidation and by way of additional earnings made possible through consolidation savings—is an unwarranted departure from fundamental principles and a misinterpretation of the language used by this Court. The point should be clarified and corrected.

The petition should be granted and the writ issued.

Dated July 24, 1950.

Respectfully submitted,

LOUIS W. GORDON,
By DONALD HAVENS,
Attorney for Petitioner.

LASZLO KORMENDI,
Of Counsel.

APPENDIX A

Text of Statutes Involved

(Italics Petitioner's)

Public Utility Holding Company Act of 1935

Section 11(e):

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, *after notice and opportunity for hearing*, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have

jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

Section 20(c):

(c) The rules and regulations of the Commission shall be effective upon publication in the manner which the Commission shall prescribe. For the purpose of its rules, regulations, or orders the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. *Orders of the Commission under this title shall be issued only after opportunity for hearing.*

Federal Administrative Procedure Act
(5 USC, Chapt. 19)

5 USC §1001(d):

ORDER AND ADJUDICATION

(d) "Order" means the whole or any part of the final disposition (whether affirmative, negative, injunctive, or declaratory in form) of any agency in any matter other than rule making but including licensing. "Adjudication" means agency process for the formulation of an order.

5 USC §1004:

ADJUDICATIONS

In every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing, except to the extent that there is involved (1)

any matter subject to a subsequent trial of the law and the facts de novo in any court; (2) the selection or tenure of an officer or employee of the United States other than examiners appointed pursuant to section 1010 of this title; (3) proceedings in which decisions rest solely on inspections, tests, or elections; (4) the conduct of military, naval, or foreign affairs functions; (5) cases in which an agency is acting as an agent for a court; and (6) the certification of employee representatives,

NOTICE OF HEARING AND ISSUES

(a) Persons entitled to notice of an agency hearing shall be timely informed of (1) the time, place, and nature thereof; (2) the legal authority and jurisdiction under which the hearing is to be held; and (3) the matters of fact and law asserted. In instances in which private persons are the moving parties, other parties to the proceeding shall give prompt notice of issues controverted in fact or law; and in other instances agencies may by rule require responsive pleading. In fixing the times and places for hearings, due regard shall be had for the convenience and necessity of the parties or their representatives.

PROCEDURE

(b) *The agency shall afford all interested parties opportunity for* (1) *the submission and consideration of facts, arguments,* offers of settlement, or proposals of adjustment where time, the nature of the proceeding, and the public interest permit, and (2) to the extent that the parties are unable so to determine any controversy by consent, *hearing, and decision upon notice* and in conformity with section 1006 and 1007 of this title.

(c) The same officers who preside at the reception of evidence pursuant to section 1006 of this title shall make the recommended decision or initial decision required by section 1007 of this title except where such officers become unavailable to the agency. *Save to the extent required for the disposition of ex parte matters as authorized by law, no such officer shall consult any person or party on any fact in issue unless upon notice and opportunity for all parties to participate;* nor shall such officer be responsible to or subject to the supervision or direction of any officer, employee, or agent engaged in the performance of investigative or prosecuting functions for any agency. No officer, employee, or agent engaged in the performance of investigative or prosecuting functions for any agency in any case shall, in that or a factually related case, participate or advise in the decision, recommended decision, or agency review pursuant to section 1007 of this title except as witness or counsel in public proceedings. This subsection shall not apply in determining applications for initial licenses or to proceedings involving the validity or application of rates, facilities, or practices of public utilities or carriers; nor shall it be applicable in any manner to the agency or any member or members of the body comprising the agency.

DECLARATORY ORDERS

(d) The agency is authorized in its sound discretion, with like effect as in the case of other orders, to issue a declaratory order to terminate a controversy or remove uncertainty. June 11, 1946, c. 324, § 5, 60 Stat. 239.

Appendix A

Act of April 9, 1948, c. 180, Amendment to U. S. Code Title 11, Relating to Railroad Reorganizations

§208. Petition subsequent to certification of reorganization plan—Duty of Commission to report changes, developments, etc., to Court; remand of plan to Commission; procedure of subsequent proceedings; referral of petition.

(a) Notwithstanding any other provision of law—

(1) with respect to any plan of reorganization or modified plan of reorganization approved by the Interstate Commerce Commission under the provisions of section 205 of this title, subsequent to April 9, 1948, it shall be the duty of the Commission, upon petition of any part to the proceeding filed at any time more than eighteen months after certification by the Commission to the court of the plan or of an order disposing of a like petition, but before any order confirming the plan shall have been entered, or, such an order having been entered, if an appeal from said order is pending on said date in a circuit court of appeals or the matter is pending in the Supreme Court on a petition to review any order of a circuit court of appeals dealing with said order of confirmation or the time within which to make such appeal or to file such petition has not expired, to report to the court in which consideration of such plans is then pending, any changes, facts or developments which have occurred since the approval of such plan by the Commission, which were not provided for in the plan, and which in the opinion of the Commission make it necessary or expedient for the Commission to reexamine or reconsider and, if necessary, to revise such plan in order to insure

that such plan, if consummated and put into effect, shall then, in the opinion of the Commission, be fair and equitable and in the public interest and compatible with the provisions of this section and section 205 of this title. Upon the filing of any such report by the Commission with the court, the court shall remand the plan to the Commission for such reexamination, reconsideration, and possible revision;

(2) if, with respect to any plan of reorganization or modified plan of reorganization approved by the Commission subsequent to April 9, 1948, the court before which such plan is then pending, for approval or confirmation, no order of confirmation having been entered, or, such an order having been entered, if an appeal from said order is pending on said date in a circuit court of appeals or the matter is pending in the Supreme Court on a petition to review any order of a circuit court of appeals dealing with said order of confirmation or the time within which to make such appeal or to file such petition has not expired, upon petition of any party to the proceeding and either with or without a hearing, shall find that changes, facts, or developments have occurred since the approval of such plan by the Commission which were not provided for in the plan and which make it necessary or expedient, in the opinion of the court, that the Commission reexamine and reconsider and revise such plan in order to insure that the plan consummated and put into effect shall then, in the opinion of the court and the Commission, be fair and equitable and in the public interest and compatible with the provisions of this section, and section 205 of this title, the

court shall return the plan to the Commission for such reexamination, reconsideration and possible revision;

(3) with respect to any plan of reorganization or modified plan of reorganization which, on April 9, 1948, is before any district court for approval or confirmation, no order of confirmation having been entered, or, such order having been entered, if an appeal from said order is pending in a circuit court of appeals or the matter is pending in the Supreme Court on a petition to review any order of a circuit court of appeals dealing with said order of confirmation or the time within which to make such an appeal or to file such petition has not expired, it shall be the duty of the Commission, upon petition of any party to the proceeding, to report to such court any changes, facts, or developments which have occurred since December 31, 1939, which were not provided for in the plan and which, in the opinion of the Commission, make it necessary or expedient for the Commission to reexamine or reconsider and, if necessary, to revise such plan in order to insure that if consummated and put into effect, such plan shall then, in the opinion of the Commission, be fair and equitable and in the public interest and compatible with the provisions of this section and section 205 of this title. Upon the filing of any such report by the Commission with the court, the court shall remand the plan to the Commission for such reexamination, reconsideration, and possible revision;

(4) in the event of the return of a plan to the Commission pursuant to the provisions of this subsection (a), the proceedings with respect thereto shall be governed by the provisions of subsection (d) of section 205 of this title;

(5) each petition filed under the provisions of paragraph (1) or paragraph (3) of this subsection shall be filed with the court before which is pending the plan which is the subject of the petition and such petition shall be referred by the court to the Commission. Upon the filing of such petition with the court all further proceedings for confirmation of the plan shall be suspended pending disposition of the petition by the Commission and certification of its action thereon to the court.

Supplemental report and order of Commission; certification of modified plan; transcript of proceeding denying modification; review by court.

(b) As to any plan so returned to the Commission by the court, the Commission, upon further hearing at which all parties may appear and submit evidence as to prospective earning power and other relevant facts, and upon consideration of all changes, facts, and developments which have occurred since the date of approval of the plan by the Commission (or which have occurred since December 31, 1939, in the case of plans which on April 9, 1948, were pending before, but had not been confirmed by, the court by order which shall have become final), including, without limitation, for such period total railway operating revenues, operating expenses and other charges, net earnings, the full effect of amortization deductions on earnings of past and future years, improvements to property, the effect of released collateral through past or future payments of loans, cash and net current assets, retirements and purchases of debt, including retirements and purchases at a discount that have been made or that can reasonably be made, adjust-

ment and reduction of interest rates on outstanding debt that may be made, shall, in a supplemental report and order, modify, or refuse to modify, any plan which it has approved, stating the reasons for such modification or for its refusal to modify the plan. The Commission, if it modifies the plan, shall certify the modified plan to the court, together with a transcript of the proceeding before it and a copy of its report and order approving the modified plan. Thereafter proceedings upon the plan shall be governed by the provisions of subsection (e) of section 205 of this title, and of this section. If the Commission refuses to modify the plan, it shall transmit to the court a copy of its report and order, together with a transcript of the proceedings before it. Thereafter, if the court shall find that the refusal of the Commission to modify the plan is based on sufficient findings and is supported by the record, the proceeding upon the plan shall continue as if the plan had not been returned to the Commission; otherwise the court shall return the plan to the Commission for further consideration. Upon such consideration, the Commission shall again certify the plan to the court with such modifications, if any, as it may find necessary, and thereafter further proceedings upon the plan shall be as provided in subsection (e) of section 205 of this title and in this section. Apr. 9, 1948, c. 180, § 3, 62 Stat. 167.

Extracts from Senate Report No. 897, 80th Congress, 2nd Sessior, Relating to Above Amendment

"Paragraph 3a (i) provides, in the case of plans of reorganization hereafter approved by the Commission in section 77 proceedings, that 18 months after the Commission has either certified a plan to a court or had disposed of a like petition filed under this paragraph, any party

affected may file a petition and as a result it shall be the duty of the Commission to report to the court any changes, facts, or developments which have taken place since the approval of the plan which make it necessary or expedient for the Commission to examine or revise the plan."

"In the opinion of the committee, the need for this type of reexamination and reconsideration is of the greatest importance where bankruptcy proceedings are pending for many years, as they generally are in most railroad cases. Evidence before the committee confirms the fact that the financial condition of railroads in reorganization proceedings changes considerably in the long periods which elapse from the time the Commission approves a plan until it is finally confirmed. There is no requirement here that the plan be changed or altered; that lies within the discretion of the Commission. But Commission representatives have testified that under existing section 77 procedures, it has no authority to volunteer advice to the court that relevant facts and conditions which affect the fairness or equitability of a reorganization plan have changed. Witnesses representing some railroads and some security holders have testified that this has resulted, in many cases, in the consummation of some reorganizations which have failed to render equity to certain classes of security holders who had no remedy or recourse at law. The committee believes that the law should be clarified and the duty of the Commission made plain."

"Paragraph 3a (2) is substantially similar to the paragraph above, but permits the court, instead of the Commission, to receive a petition and give consideration to whether changes, facts, or developments have occurred which make it necessary or expedient for the Commission to reexamine, revise, or reconsider a plan. If the court

so finds, it may return the plan to the Commission for such revision."

"Paragraph 3a (3) is a parallel provision to the two preceding paragraphs and merely provides that in certain reorganization cases still pending the Commission must report to the court any changes, facts, or developments which have taken place since December 31, 1939, and which were not provided for in the plan it approved."

"Subsection (b) of this section provides for a public hearing in the event a plan is returned to the Commission. It spells out the factors that the Commission must evaluate and on which parties will offer evidence in reconsideration of a plan. The Commission, after such hearing and consideration, may modify or refuse to modify the plan. If the former, it certifies the modified plan to the court and proceedings continue on the modified plan under section 77 as they did on the original plan. If the Commission refuses to modify, it also transmits its order and the transcript for court consideration. If the court finds the Commission's refusal to modify the plan is based on sufficient findings and is supported by the record, the original section 77 proceedings shall continue as if the plan had never been returned to the Commission. If, however, the court does not so find, it shall return the plan to the Commission for further consideration, after which the Commission shall again certify the plan to the court. The entire procedure here is consistent with the authority and dignity of a court considering bankruptcy cases in which equity is required to be done. It places upon the court the authority to determine whether the facts support the Commission's decision and to that degree places a check upon arbitrary and capricious action by administrative bodies."

APPENDIX B

Summary of Some of the Relevant Facts Bearing on Developments Since the Original Approval of the Plan by the Commission

Net Income of Long Island System Earned for Existing Stock Investment:

Net Income for Calendar Year 1949	$2,766,606.00	(R. 718)
Long range estimate of foreseeable future net income by the Commission, based on earning power of March 31, 1949 facilities and reflecting expected reduction in operating expenses upon introduction of natural gas	3,500,000.00	(R. 209)
Net Income Earned in Calendar Year 1949 without any Natural Gas	3,577,279.00	(R. 718)
Net Income Earned during Four Months ended April 30, 1950, without any Natural Gas	1,500,438.00	(R. 907)
Company's Budget Estimate of Net Income for Calendar Year 1950	4,026,953.00	(R. 935)

Construction Program:

Rate of New Construction as Estimated by Management before the Commission in January, 1949 (in millions of dollars):

1948	1949	1950	1951	1952	1948-1952	
15.4	15.5	17.8	9.3	65.9	65.9	(R. 758)

Rate of New Construction as reported and estimated by the Management in its 1949 Annual Report published in March, 1950 (in millions of dollars):

1948	1949	1950	1951-1952
16.5	15.4	"over 20."	No specific figures beyond 1950 are given but the following statement is made: "Our construction program must be closely correlated with the greater outlook for residential building. The rate of growth gives no present indication of abating * * *. Present conditions point to a construction requirement over the next few years of greater size than we have ever experienced thus far." (R. 928)

Rate Base:

The March 31, 1949 "Rate Base" as computed by the Commission was:

Net Utility Plant	$100,680,850.00	
"Allowable" Working Capital	6,854,150.00	
Total	$107,535,000.00	(R. 910)

Appendix B

Based on April 30, 1950 Company figures, the net utility plant as of that date was $120,125,647.00, an increase of over $19,000,000.00 (R. 910).

Net Income Earned Between March 31, 1949 and April 30, 1950 and reinvested in new construction was $3,893,729.00 (R. 907).

On the basis of the 1950 Company budget estimate, the Net Income Earned since March 31, 1949 and reinvested in new construction by the end of 1950 will have aggregated $6,420,244 (R. 909).

The ratio of debt to total capitalization has nevertheless decreased since March 31, 1949, despite this large expansion (R. 910).

Natural Gas:

The Commission's findings were based on the assumption that the Company will receive from the Transcontinental Gas Pipeline Corporation, 20,000,000 cubic feet of gas per day, with an increase in certain contingencies to a maximum of 25,000,000.

Since that time, Transcontinental has applied for an increase in the capacity of the pipeline, amended its contract with the Company increasing the supply of natural gas to the Long Island System from 20,000,000 to 35,000,000 cubic feet per day (R. 802; 833-834) and this, as estimated by the Company before the Federal Power Commission, will mean a reduction in operating expenses of $3,197,600.00 per annum during 1951 and 1952, and of $3,428,000.00 in 1954 and thereafter, an increase in savings over those previously estimated of $589,800 per annum and $737,500.00 per annum subsequent to 1952 (R. 837).

Appendix B

The Federal Power Commission has recently granted the application and authorized the increased allocation of natural gas to the Long Island System (Opinion No. 191, Docket G-1277 of the Federal Power Commission dated April 28, 1950). The supply of 35,000,000 cubic feet of natural gas per day to the Long Island System, beginning with November of this year, is only the first phase of a more general development in this area toward the increased use of natural gas for house and industrial heating and other purposes in displacement of oil and coal (R. 799-802). According to estimates made by the management of Transcontinental Gas Pipeline Corporation, the amount of natural gas available for the New York area by November, 1950 will be doubled within the next three years and trebled within the next five years, making "straight" natural gas available to consumers for use in housing and industrial heating and other purposes.*

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* *Wall Street Journal*, issue of March 27, 1950, page 5:

"The six million gas customers in the New York City area will be using straight natural gas within five years after this fuel becomes available next November 1.

"This forecast was made by Claude A. Williams, president of Transcontinental Gas Pipe Line Corp., which is building a $190 million pipeline to bring natural gas from Texas to New York City * * *.

"Initial delivery of natural gas to New York will begin at the rate of 200 million cubic feet daily by November 1, Mr. Williams predicted, and within the following 60 days the pipeline will be delivering natural gas at its proposed capacity of 505 million cubic feet daily. He expressed confidence that the Federal Power Commission would rule favorably by mid-April on the company's application to increase authorized capacity from 340 million cubic feet to the 505 million level.

* * *

Appendix B

General Growth of Territory:

The 1949 Annual Report of the Company, published in March, 1950, gives the following information with respect to population, building and industrial growth in the territory served by the Long Island System:

"The territory served by the System—Nassau and Suffolk Counties and a small portion of Queens County in New York City—is one of the most rapidly growing areas in the country. Its population has increased 40% since the end of World War II and now exceeds 1,000,000. More than one-quarter of all the new dwelling units built in New York State during the last four years are in our service area.

"This growth arises from a migration of people who are seeking their own homes in the country and a better way of living. They are principally young couples who want to raise their families in suburban or rural surroundings, with all the recreational facilities for which Long Island is famous—fishing, swimming, boating, golf, and a multitude of others.

"Gas consumers in the New York-Philadelphia-New Jersey area will 'inevitably' realize substantial savings in their gas bills as a result of the introduction of natural gas, he declared. This prediction is based on a 250 page study made by Transcontinental of the results in cities where natural gas has been introduced to replace manufactured gas—Washington, D. C., Chicago, Detroit, Atlanta and Denver, he said.

"Based on results in these cities, Mr. Williams estimated that natural gas consumption in New York City would double within three years after it becomes available and would triple within five years, as more consumers are attracted by the lower rates made possible by use of natural gas. He predicted that the New York City area would use a billion cubic feet of natural gas daily by 1955 if consumption increases at the average rate reported for the cities in study."

Appendix B

"The majority of our new residents commute to New York City, but increasing numbers are finding employment near their homes. Commerce and light industry have more than kept pace with the growth in population, a logical development for a location so close to the country's largest mass market. The New York State Department of Commerce terms the 800% increase in Nassau County's manufacturing volume within eight years the "most spectacular" in the State.

"Airplane manufacture is still the largest industry in the territory, with a weekly payroll of $1,500,000. A recent development, however, is the increasing number of research laboratories, which are particularly desirable because they give employment in the middle income brackets. The largest of these is the Government's Brookhaven National Laboratory for atomic research, where a permanent staff of eight hundred scientists and technicians is planned, as well as one thousand additional employees. Thirty-five research organizations are now located in our territory.

"The question of how far this growth will continue is one that we follow closely, not only to plan our own requirements, but also to help in the development of a sound and balanced economy for the entire community. We see room for growth for many years to come without impairing those advantages which lead people and businesses to locate on Long Island. The population density of Nassau County is less than one-fifth that of Queens County, the part of New York City adjacent to our territory; while Suffolk County, the western part of which is within commuting range of New York City, offers almost unlimited opportunity for development. While we are unable to predict the future, there are no present indications of any early slackening of the pace."

NOTE: By inadvertence, from the unconsolidated
on pages 920 to 927 of the Record, one
Company'' has been omitted. It is prin

LONG ISI

Comparative Statement of Incon

	Month of April		
	1950	1949	Incre Decre
OPERATING REVENUES:			
Sales of Electricity	$ 2,151,321	$ 1,827,714	$ 32
Sales of Gas	708,245	626,330	8
Other Operating Revenues	10,750	12,392	
Total Operating Revenues	$ 2,870,316	$ 2,466,436	$ 40
OPERATING REVENUE DEDUCTIONS:			
Operating Expenses	$ 1,304,841	$ 1,141,849	$ 16
Maintenance	285,530	234,951	5
Depreciation	237,678	219,067	1
Operating Taxes	326,697	276,467	5
Income Taxes	227,576	163,883	6
Total Operating Revenue Deductions	$ 2,382,322	$ 2,036,217	$ 34
OPERATING INCOME	$ 487,994	$ 430,219	$ 5
OTHER INCOME—NET	(489)	(748)	
GROSS INCOME	$ 487,505	$ 429,471	$ 5
INCOME DEDUCTIONS:			
Interest on Long-term Debt	$ 161,345	$ 130,014	$ 3
Other Interest	17,239	22,183	
Interest Charged to Constr.—Cr.	—0—	—0—	—(
D. D. & E. Amortiz. and Misc.	2,163	9,862	
Total Income Deductions	$ 180,747	$ 162,059	$ 1
NET INCOME	$ 306,758	$ 267,412	$ 3
NOTE: Amount of net Income, reserved, pursuant to orders of the P.S.C.	$ 43,786	$ 106,367	$ 6

This statement is not furnish
the purpose of promoting, in
1949 Rec

( ) Denotes Red Figure

EXHIBIT C

NOTE: By inadvertence, from the unconsolidated April 30, 1950 financial statements of the System companies, printed on pages 920 to 927 of the Record, one sheet, "Comparative Income Statement of Long Island Lighting Company" has been omitted. It is printed below.

LONG ISLAND LIGHTING COMPANY

Comparative Statement of Income for Periods Ending April 30, 1950 and April 30, 1949

	Month of April			Four (4) Months Ending April 30			Twelve (12) Months Ending April 30		
	1950	1949	Increase or Decrease –d	1950	1949	Increase or Decrease –d	1950	1949	Increase or Decrease –d
.....	$ 2,151,321	$ 1,827,714	$ 323,607	$ 8,931,944	$ 7,881,868	$ 1,050,076	$23,974,320	$21,424,976	$ 2,549,344
.....	708,245	626,330	81,915	2,801,799	2,603,692	198,107	7,153,022	6,747,895	405,127
s	10,750	12,392	1,642–d	44,774	45,398	624–d	142,677	125,705	16,972
Revenues ...	$ 2,870,316	$ 2,466,436	$ 403,880	$11,778,517	$10,530,958	$ 1,247,559	$31,270,019	$28,298,576	$ 2,971,443
CTIONS:									
.....	$ 1,304,841	$ 1,141,849	$ 162,992	$ 5,552,680	$ 5,158,041	$ 394,639	$15,068,838	$14,382,154	$ 686,684
.....	285,530	234,951	50,579	1,075,943	872,880	203,063	2,892,810	2,554,702	338,108
.....	237,678	219,067	18,611	957,407	875,466	81,941	2,794,581	2,347,022	447,559
.....	326,697	276,467	50,230	1,326,693	1,103,841	222,852	3,546,980	3,048,785	498,195
.....	227,576	163,883	63,693	840,636	719,599	121,037	1,861,037	1,475,528	385,509
Revenue De-	$ 2,382,322	$ 2,036,217	$ 346,105	$ 9,753,359	$ 8,729,827	$ 1,023,532	$26,164,246	$23,808,191	$ 2,356,055
.....	$ 487,994	$ 430,219	$ 57,775	$ 2,025,158	$ 1,801,131	$ 224,027	$ 5,105,773	$ 4,490,385	$ 615,388
.....	(489)	(748)	259	(2,319)	(2,990)	671	(2,982)	(3,130)	148
.....	$ 487,505	$ 429,471	$ 58,034	$ 2,022,839	$ 1,798,141	$ 224,698	$ 5,102,791	$ 4,487,255	$ 615,536
ebt	$ 161,345	$ 130,014	$ 31,331	$ 645,379	$ 520,054	$ 125,325	$ 1,906,317	$ 1,560,163	$ 346,154
.....	17,239	22,183	4,944–d	60,889	83,415	22,526–d	132,413	186,796	54,383–d
str.—Cr.	—0—	—0—	—0—	—0—	(1,911)	(1,911)d	(148,469)	(218,880)	(70,411)d
Misc.	2,163	9,862	7,699–d	9,559	18,026	8,467–d	35,390	77,451	42,061–d
uctions	$ 180,747	$ 162,059	$ 18,688	$ 715,827	$ 619,584	$ 96,243	$ 1,925,651	$ 1,605,530	$ 320,121
.....	$ 306,758	$ 267,412	$ 39,346	$ 1,307,012	$ 1,178,557	$ 128,455	$ 3,177,140	$ 2,881,725	$ 295,415
me, reserved, of the P.S.C.	$ 43,786	$ 106,367	$ 62,581–d	$ 175,145	$ 425,471	$ 250,326–d	$ 525,438	$ 1,276,412	$ 750,974–d

This statement is not furnished in connection with any offering of securities nor for the purpose of promoting, influencing or effecting the sale or purchase of securities.

1949 Reclassified for Comparative Purposes.

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FILED
SEP 8 1950
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1950

Nos. 220, 249

COMMON STOCKHOLDERS COMMITTEE OF LONG ISLAND LIGHTING COMPANY,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION, LONG ISLAND LIGHTING COMPANY, QUEENS BOROUGH GAS AND ELECTRIC COMPANY, NASSAU & SUFFOLK LIGHTING COMPANY.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

J. DONALD HALSTED, E. M. NICHOLS and B. F. GRIZZLE as a Protective Committee for the Holders of the Common Stock of Long Island Lighting Company,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION.

ON A PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

PETITIONERS' REPLY BRIEF

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Dated: September 6, 1950.

APPEAL PRINTING CO., INC., 130 CEDAR STREET, NEW YORK, WO 4-3033

IN THE

Supreme Court of the United States

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PETITIONERS' REPLY BRIEF

We have chosen to follow the example set by the Securities and Exchange Commission and serve a single reply brief in No. 220 and No. 249.

Replying to the Brief for Respondents Long Island Lighting Company, et al., in Nos. 220 and 221

This brief, after stating that the companies

> "adopt the views and arguments of the Securities and Exchange Commission expressed in its brief in opposition to the petitions for a writ of certiorari." (p. 3)

states that it is submitted "in order to bring to the Court's attention the serious financial problems of the System companies occasioned by the long and, in part, undue delay, in consummating the reorganization and consolidation which qualified administrative agencies have, after a detailed examination, found necessary in the public interest."

The remainder of the brief is devoted to an attack upon the common stockholders' motives.

The Company has neglected to point out to the Court that by stipulation (R. p. 406) both the Company and the Securities and Exchange Commission agreed that consummation of the reorganization would be deferred until after this Court's decision. Thus, the alleged delay caused by this application could, if the Companies' complaint is made in good faith, have been avoided by applying for an order of consummation and not stipulating to defer consummation until after decision of this application. The making of the stipulation is a conclusive admission by all parties thereto that serious questions exist which should be passed upon by this Court.

Replying to Brief of Respondent Committee of Preferred Stockholders of Long Island Lighting Company

Amazingly enough, this brief argues first that the 1944 recapitalization plan

> "never came into effect, and accordingly, any claim based thereon is totally synthetic. Moreover, in any event, the Securities and Exchange Commission has taken the claim into account in evaluating the common stockholders' 'bundle of rights', and the District Court and Court of Appeals have examined and approved the Commission's determination in that regard." (pp. 1 and 2)

By this statement the Preferred Stockholders' Committee has exposed one of the inherent vices in the determinations below. The brief argues first that the recapitalization never became effective and, therefore, is irrelevant in the determination of what the common stockholders should receive.

The Commission, in its decision, did not determine whether the 1944 recapitalization became effective. Upon the hypothesis that it did become effective, the Commission found that it would take about seven years for the preferred dividend arrearages to be made up (R. 233). Then, upon the hypothesis, that the 1944 recapitalization did not become effective, the Commission found that it would take approximately fourteen years for these arrearages to be made up (R. 234). Thus, without determining which of these hypotheses would govern the ultimate determination, it allotted 5.71% of the stock in the consolidated corporation to the common stockholders.

If the Preferred Stockholders' first argument is correct, that is, that the 1944 recapitalization never became effective, why did the Commission, in its opinion, use that hypothesis to measure what the common stockholders should receive? This use, of course, is completely at variance with, and in contradiction of, the Commission's present position which, as stated in its present brief (p. 19), is that

> "The Commission was free to disregard both the formal action taken by the Company after the commencement of the proceedings before this Commission and the reluctant consent given by the New York Commission (R. 394,867)."

If this was the position of the Commission upon its original determination, why did it not say so instead of testing the common stockholders' rights on the basis of both hypotheses?

The second point of the Preferred Stockholders' brief (p. 7) is that

> "The Securities and Exchange Commission fairly compromised the claim of the common stockholders based upon the 1944 recapitalization plan."

Even the Commission does not contend that it compromised this claim. It contends merely that it was "free to disregard" the 1944 recapitalization. If it argues that it is free to disregard it, presumably that is what the Commission did, otherwise there would be no point in making the argument.

The facts are, of course, that the Commission has never clearly, fairly, or specifically stated what it did. So far as examination of the decision and briefs can clarify this question, it would appear that the Commission did disregard the claim and endeavored to cloak its disregard in the obscurity created by the references in its original opinion (R. 233, 234) to the existence of the claim.

Replying to the Brief of Respondent Securities and Exchange Commission Submitted in Nos. 220 and 249

This brief is most remarkable for what it omits, rather than what it contains. It omits both fair statements and

relevant discussion of the specific contentions relied upon for the granting of the writs, and conceals the omissions by misstating our contentions, and then rebutting the misstatements.

Thus, at page 14, it says

> "1. The committee contends that the Long Island system, being predominantly intrastate in character, is not constitutionally subject to the reorganization provisions of Section 11 of the Holding Company Act (Committee Petition 24-29)."

The citation is erroneous for it should refer to pages 24-29 of our brief, not our petition, where we contend not that the Company is "predominantly intrastate in character" but "wholly" intrastate, since both by incorporation, operation, location of properties and every other test, this system is not in, nor does it affect interstate commerce.

The Commission has also deliberately avoided meeting our contention that its estimate of foreseeable income is erroneous as a matter of law, because, although allegedly based upon the future availability of natural gas, which will effect very large economies, it is actually lower in amount than the Company's actual earnings for the period before natural gas becomes available. In an attempt to conceal the fact that it cannot answer this argument, the Commission's brief makes the following misstatement of our position at page 22:

> "Equally without merit is the contention that the proceedings should be remanded because the actual earnings for 1949 have exceeded the Commission's estimate (Committee Petition, pp. 18-19)."

The Commission endeavors to make the Court believe that our claim of error is based upon a mere discrepancy between actual income and estimated income. We have endeavored to make clear that our claim of error is based not upon mere discrepancy between estimate and actuality, but upon the additional fact that actual income, without the availability of natural gas, exceeds the Commission's estimate of income after the availability of natural gas, when all parties agree that the availability of natural gas will effectuate tremendous savings. So true is this that the Commission, in its original opinion rejected an expert's opinion of estimated income because he did not give weight to the impending availability of natural gas. Historical facts now show that the Commission has made the same error for which it rejected the testimony of the expert.

Here is no mere discrepancy in amount, here actual operations have proved that the Commission's estimate does not give effect to increased income from natural gas because, before natural gas has arrived, the Company's income is greater than the Commission estimated it will be after it has been increased by the availability of natural gas.

The Commission's failure to recognize and answer this argument is an admission by silence that it is unanswerable and is sufficient, standing alone, to call for review and reversal.

Regarding the Commission's Prohibition of Solicitation for Voluntary Contributions

The Commission endeavors to expand the statutory provisions of Section 12 (e) of the Holding Company Act which vests it with authority over the solicitation of any

"proxy, power of attorney, consent, or authorization regarding any security of a registered holding company" to include a voluntary solicitation of funds by mere statement without argumentation (pp. 31, 32, Brief of Securities and Exchange Commission). It says that the need for this expansion is shown by the "evils and abuses of the use of deposit agreements in reorganization, a device closely related to the solicitation of contributions" (Commission's Brief, p. 32).

The Commission does not endeavor to show how a voluntary solicitation of contributions has been or may be abused as deposit agreements were.

With deposit agreements, the evil arose because the depositor lost the control of his security and made the depositary the judge of its own fee. No such evil exists with regard to voluntary contributions, especially in this case where there was no question of making the Committee or its counsel or accountants the judges of their own fees. Again, the Commission's refusal to meet our arguments squarely is an admission that the arguments cannot be answered. Judge Miller's dissenting opinion in the Court of Appeals for the District of Columbia, which states that if Congress had intended to vest the Commission with jurisdiction over voluntary contributions then "Congress would not have been content to describe a voluntary contribution to the expense fund of a lawful agent as a 'proxy, power of attorney, consent, or authorization' regarding a security" is the full answer to the Commission's argument.

The Commission still refuses to explain how the protective committee could have operated as efficiently without accountants, engineers, experts, and minutes of the proceedings, as it could with their assistance. Both Com-

mission and Company had such assistance, but the Committee was prohibited from obtaining it, and treated as a second-class litigant. The Commission's refusal to explain is an admission of error.

This Court should direct that writs of certiorari issue in both cases.

Respectfully submitted,

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FILED
SEP 23 1950
CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1950

No. 221

LOUIS W. GORDON, Common Stockholder of Long Island Lighting Company,

Petitioner,

against

SECURITIES AND EXCHANGE COMMISSION, LONG ISLAND LIGHTING COMPANY, QUEENS BOROUGH GAS AND ELECTRIC COMPANY, NASSAU & SUFFOLK LIGHTING COMPANY,

Appellees-Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONER'S REPLY BRIEF

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Dated, September 22, 1950.

APPEAL PRINTING CO., INC., 130 CEDAR STREET, NEW YORK, WO 4-3033

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PETITIONER'S REPLY BRIEF

Replying to Brief of Securities and Exchange Commission

I

The Commission's brief challenges the *locus standi* of petitioner Gordon on the ground that he did not participate in the administrative hearings. Participation in the S. E. C. hearings is not a condition of becoming a party objectant to the Plan in the District Court. As a stock-

holder, petitioner had a statutory right to object to enforcement of the Plan. *In Re Engineers Public Service Co.,* 168 Fed. (2) 722, 731-732; see *American Power & Light Co.* v. *S. E. C.,* 325 U. S. 385, 388-391.

The Commission complains further that Gordon had "acquired his stock after the hearing was closed" but omits to state that Gordon had become a stockholder many months before the Plan was approved by the Commission and its order of approval entered.* He was, therefore, both "aggrieved" and "affected" by the Commission's order approving the Plan.

There is no claim that Gordon was a director or other fiduciary taking unfair advantage of "inside knowledge" when he acquired his stock. It is settled law that he is entitled to urge all objections to the Plan common to the class of which he is a member. *Comstock* v. *Group of Investors,* 335 U. S. 211, 226; see *Manufacturers Trust Co.* v. *Becker,* 338 U. S. 304.

In fact, Gordon is in at least as good a position as the various Committees in the case. These act under simple powers of attorney from security holders who, despite having given powers to the Committees, have been free to dispose of their holdings on the New York Curb Exchange where the stocks are listed and have been actively traded in during the five years during which the Section 11 proceeding has been pending.

II

The Commission reiterates its position (pp. 20-23) in complete reversal of its earlier practice (see Gordon peti-

* The Commission's Findings and Opinion were issued in November 1949 (R. 145). The minutes in the District Court disclose that Gordon purchased his 50,000 shares between April 11, 1949 and September 13, 1949.

tion, pp. 9-10) that the possibility that the existing equity investment will benefit in terms of incremental earnings from post-1949 expansion of plant and facilities is too "remote and speculative" to be susceptible of forecast. It does not deny that it failed and refused to consider evidence tending to show that such expansion will in fact increase the earning power of the existing equity investment. It does not deny that this has already taken place; that the company's own budget estimate of net income for 1950 exceeds the Commission's estimate of $3,500,000 by more than $500,000 (R. 935), that interim 1950 earnings are at approximately the budget rate (R. 907 and see page 11 of this brief) and that such increase in earnings is due to an enormous increase in the "rate base" which has already taken place (R. 910), viz., to the very expansion of plant and facilities which the Commission has claimed cannot produce earnings for the existing equity.

The claim that the common stock of the Consolidated Company can benefit from new construction only to the extent that it is financed by the sale of bonds and cannot benefit to the extent that capital is raised by the sale of "stock" (p. 21), is demonstrably false and misleading. The Consolidated Company will emerge from the reorganization under the Plan with only common stock and bonds. It will be in a position to sell preferred stock—a form of security of which many hundreds of millions of dollars worth are being sold by utility companies every year at a yield which leaves a substantial margin for the common, assuming a normal rate of return. And even if a part of future property additions should be financed by the sale of additional common stock of the Consolidated Company, the earnings from even such property additions will not accrue exclusively to the new common unless the new common should be sold at a price equal to the asset value

of the old common and not, as is reasonable to assume in the case of a company having, in the words of the Commission, "extremely favorable business prospects" (R. 889), at a somewhat higher price. All these were matters for experts to demonstrate and forecast, as they have done in other Section 11 cases before the Commission, but the Commission, having refused to consider evidence of this character in this case, defends a position already taken by asserting that it is beyond the possibility of proof and that a negative answer must be conclusively presumed.

In *Group of Institutional Investors* v. *Milwaukee Railroad Company,* 318 U. S. 523, 542-544, this Court held that the *wartime* earnings of a railroad are temporary in character and not indicative of permanent long range earnings on which a future earning estimate for reorganization purposes must necessarily be based. But here the rise in earnings is admittedly not due to temporary conditions but to the continuing phenomenal growth of the territory in which the Long Island System has a monopoly in supplying light, heat and power, and the concomitant necessary expansion of plant and facilities, viz., of the rate base.

III

The procedure followed by the Commission in the Court below in connection with disposing of the issue of consolidation savings of $250,000 per annum is defended as consistent with due process on the ground, adopted by the Court of Appeals, that what the Commission did in its Supplemental Findings and Opinion was to make additional findings on the existing record and—

> "a new hearing was not required any more than a new hearing would be required before a District

> Judge if we (the Court of Appeals) asked the Judge to see what findings of fact he had acted on but had not expressed in his opinion." (Commission's brief, p. 26)

There is here a misuse of the word "hearing". It may well be that a Court or an administrative tribunal to which a case is referred back for additional findings need not have a "hearing" in the sense of taking additional evidence if it decides that the new findings can be made upon the evidence already taken. But it cannot, without violating procedural due process, make new or supplemental findings without first giving notice to *all parties* that it proposes to do so and an opportunity to all of them to address themselves to the Court or administrative body, at least by argument, on the subject on which new or supplemental findings are proposed. One of the purposes of such an argument is to help the Court determine whether or not the new or supplemental findings can be made on the existing record or only after taking additional evidence. In the case at bar, the new findings were made on the basis of "representations" of the proponents of the Plan, behind the back of its opponents; without any notice that they were to be made and without any opportunity to them to be heard. While the opponents of the Plan were waiting for the remand of the case, they were confronted with the accomplished fact of new findings without a remand. That such a procedure is in flagrant violation of procedural due process is established by decisions of this Court. In *Morgan* v. *United States,* 304 U. S. 1, this Court said:

> "* * * The right to a hearing embraces not only the right to present evidence but also a reasonable opportunity to know the claims of the opposing party and to meet them. The right to submit argu-

ment implies that opportunity; otherwise the right may be but a barren one. Those who are brought into contest with the Government in a quasi-judicial proceeding aimed at the control of their activities are entitled to be fairly advised of what the Government proposes and to be heard upon its proposals before it issues its final command." (pp. 18-19)

* * * * *

"* * * If in an equity cause, a special master or the trial judge permitted the plaintiff's attorney to formulate the findings upon the evidence, conferred *ex parte* with the plaintiff's attorney regarding them, and then adopted his proposals without affording an opportunity to his opponent to know their contents and present objections, there would be no hesitation in setting aside the report or decree as having been made without a fair hearing. The requirements of fairness are not exhausted in the taking or consideration of evidence but extend to the concluding parts of the procedure as well as to the beginning and intermediate steps." (pp. 19-20)*

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* The cases cited by the Commission (pp. 26-27) decide nothing to the contrary. *Federal Communications Commission* v. *WJR, The Goodwill Station, Inc.*, 337 U. S. 265 simply holds that the right to *oral* argument is not essential to procedural due process provided a reasonable opportunity to submit arguments in writing has been afforded. In *Old Colony Bondholders* v. *N. Y., N. H. and H. R. Co.*, 161 Fed. (2) 415, following an earlier remand of a railroad reorganization plan to the I. C. C. on a specific issue, the I. C. C. rendered a supplemental report and findings on such issue adhering to its original approval of the plan, without taking new evidence. But an examination of the proceedings taken before the I. C. C. (261 I. C. C. Reports 195-210) shows that before the supplemental report and opinion was issued, *all* parties had been given an opportunity to address themselves to the I. C. C. Upon consideration of all petitions, arguments and specific offers of proof, the I. C. C. issued its supplemental findings and order approving the plan and denied *inter alia* the need for additional proof.

Had notice been given of the fact that new and supplemental findings were to be made prior to remand, and opportunity to be heard thereon been afforded to petitioner, the Commission could not have, without an abuse of discretion, refused to consider evidence—later vainly proffered before the Court of Appeals—showing that due to the enormous increase in the rate base since the original findings were made, the $250,000 of admitted consolidation savings will in no event have to be returned to the consumer in the form of rate reductions nor are they needed as a "margin of safety" for the Commission's income estimate in possible poor years. It is elementary that in any proceeding which is essentially equitable in nature the rights and equities of the parties must be determined in accordance with the facts as they exist as of the time of the decree and not of any earlier time. (*Randel* v. *Brown*, 2 Howard (U. S.) 406, 423; *Stonega Coke & Coal Co.* v. *Price*, 106 Fed. (2) 411, 419.)

* * * * *

The argument that the Administrative Procedure Act is inapplicable because the effective date of the Act is December 11, 1946, and the simplification proceedings in the matter of Long Island Lighting Company and subsidiaries originated in 1945, is a distortion of the language of that Act. It is true that Section 12 of the Administrative Procedure Act (5 USC §1011) provides that—

> "No procedural requirement shall be mandatory as to any *agency proceeding* initiated prior to the effective date of such requirement."

but the term "agency proceeding" is defined in Section 2(g) of the same statute (5 USC §1001) as meaning—

> "any agency process as defined in sub-sections (c), (d), and (e) of this section".

Sub-section (d) of the same section reads as follows:

> " 'Order' means the whole or any part of the final disposition (whether affirmative, negative, injunctive, or declaratory in form) of any agency in any matter other than rule making but including licensing. 'Adjudication' means agency process for the formulation of an order."

The Supplemental Findings and Opinion were the result of an application therefor filed by the companies with the Commission on June 5, 1950 (R. fols. 1918-1919). This application, and the action taken thereon by the Commission, constituted an "agency process" in the sense of an "adjudication" as defined in the Administrative Procedure Act. This "agency process" began on June 5, 1950, almost five years after the effective date of the Administrative Procedure Act. This construction not only follows from the explicit language of the Act but the contrary construction urged by the Commission would emasculate the Act and lead to an absurd result. Simplification proceedings under Section 11 of the Public Utility Holding Company Act are notoriously long-drawn out. They take many years with intermittent hearings of some days and weeks, followed by months and years of quiescence. Many of these simplification proceedings, initiated years ago, are still pending, with plans still in preparation. Conditions change, plans are withdrawn, changed, resubmitted, disapproved, etc. The "proceeding" in the sense of Section 11 of the Holding Company Act is still the original "proceeding" but this Section 11 proceeding consists of a large number of separate "agency proceedings" within the meaning of the Administrative Procedure Act. To hold that applications and petitions filed years after the effective date of the Administrative Procedure Act and resulting in new hear-

ings, orders and decisions, are not entitled to the protection of the Act would lead to an absurd, unfair and unnecessary result.

The matter is obviously of great general importance and the misconception of the Commission as to the meaning of the Act should be corrected by a ruling of this Court.

IV

The Commission argues (pp. 27-29) that no legal error was committed in first allotting to Long Island, as against Queens and Nassau, 83.7% of the total capital stock of the Consolidated Company in accordance with the Commission's finding that *all* the stockholders of Long Island are entitled to receive, after *weighing* Long Island's relative income, asset and credit contribution to the consolidation, 83.7%, or $2,929,500 of the estimated consolidated earnings of $3,500,000 per annum; and then proceeding to apportion the stock so allocated to Long Island, as between the preferred stockholders of Long Island on the one hand and the common stockholders of Long Island on the other hand, on the basis of a hypothetical future income stream allocable to Long Island of $2,815,000 only, viz., as if Long Island had received only 80.42% of the stock of the Consolidated Company (see Gordon petition, pp. 17-18). A simple illustration will suffice to demonstrate that despite all the verbiage employed by the Commission in justifying this allotment the position of the Commission does not stand analysis and that the error remains an error. Suppose manufacturing company A, equipped with very high quality assets and a very high credit rating, has a foreseeable future income expectancy of $1,000,000 a year. It has two classes of stock, preferred and common; the preferred is not in arrears and

is entitled to a fixed dividend of $1,000,000 a year. If company A were recapitalized standing alone, under a plan calling for the issue of one class of common stock only, a plan based on prospective earnings would allocate all the new stock to the preferred and none to the common.* Suppose, however, that company A merges with, or consolidates with, company B and that company B, standing alone, has a future income expectancy of $2,000,000 a year but less desirable credit and lower quality assets. Suppose further that in recognition of the fact that company A, apart from its own income, will contribute its superior credit rating and very high quality assets to the consolidation, the merger terms allocate to the stockholders of company A not 33.13% of the capital stock, being all common stock of one class, of the company resulting from the merger or consolidation, but 50%, so that 50% of the expected future combined net income of $3,000,000, or $1,500,000 per annum, will flow to the former stockholders of company A. If the Commission's argument is correct, the new stock allocated to company A under the merger terms will be apportioned as between the preferred and common stockholders of company A on the basis of a future income expectancy of only $1,000,000 and the result is that the preferred stock of A will get all the new stock including all the consolidation benefits, and the common will be eliminated. If, as we contend, the $500,000 per annum of consolidation benefits accruing to company A must be taken into account in the allocation as between the preferred shares and the common shares of company A, the common stock of company A will obviously receive some substantial participation.

---

* We assume no voting control by the old common in this example which might require some recognition in allocations.

The position of the Commission on this issue shows a fundamental error and misconception of the rule of substantial equivalence as applied to reorganizations coupled with mergers or consolidations. In addition to its sweeping powers in connection with Holding Company Act reorganizations, the Commission, by virtue of its advisory functions, has a dominant influence in Chapter X reorganizations as well. The error committed in this case might furnish a pernicious precedent for future reorganizations unless corrected by this Court.

The Commission claims that this point was not covered by the formal objections filed in the District Court, nor raised on appeal and hence should not be considered now. The point was adequately covered in petitioner's Statement of Objections to the District Court which excepted to the finding of the Commission with respect to "the amount of future or prospective net income estimated by the Commission for each of the constituent companies" (R. fol. 1075) as well as to the finding that "the allocation of 5.715% of the new common stock to the old common stock of Long Island is fair and equitable" (R. fol. 1076). It was made the subject of a specific and elaborate presentation to the Court of Appeals by this petitioner (R. 914-916).

Reply to the Brief of Long Island Lighting Company, *et al.*

The company's brief (p. 8) compares the S.E.C.'s long range future estimate of $3,500,000 with the recently published consolidated net earnings for the twelve months ended June 30, 1950 of $3,687,000. It does not tell the Court that the consolidated net earnings for the six months ended June 30, 1950, issued by the company as part of the same statement, are $1,938,616, reflecting the

progressive rise of net income due to the rapid growth and expansion of plant, facilities and service in the area. This six months figure is in line with the company's own budget estimate of approximately $4,000,000 for the entire 1950 as against the S.E.C.'s permanent long range estimate of $3,500,000. And all this without a drop of natural gas which will arrive only at the end of this year.

The company also seeks to justify the S.E.C.'s future estimate on the ground of the "Korean embroilment", viz., that war conditions *might* result in decreased utility earnings. If, as this Court has held, the rise in earnings in some industries during World War II, being temporary in character, will not justify an *upward revision* in valuing the equity for reorganization purposes (*Group of Institutional Investors* v. *Milwaukee Railroad Co.*, 318 U. S. 523, 542-544), the possible temporary adverse effect on utilities of the "Korean embroilment" should not justify a *downward* revision of foreseeable future earnings for reorganization purposes.

Respectfully submitted,

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